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VIA ELECTRONIC FILING

January 30, 2007

Chairman Kevin J. Martin
Commissioner Michael J. Copps
Commissioner Jonathan S. Adelstein
Commissioner Deborah Taylor Tate
Commissioner Robert M. McDowell
Federal Communications Commission (via ECFS)

Re: Ex Parte Communication, Universal Service Contribution Methodology, WC Docket No. 06-122

Dear Chairman Martin and Commissioners:

IDT Corporation ("IDT") is a founding member of the USF By the Numbers Coalition, which released today the attached document titled, "The Consumer Benefits of a Numbers-Based Collection Mechanism to Support the Federal Universal Service Fund." This document illuminates the important benefits that would be realized by consumers if the Commission were to adopt a USF collection mechanism based in whole or in part on consumers' working telephone numbers. IDT believes that this document should be included in the record for this proceeding.

Please let me know if you have any questions about this filing. Thank you.

Respectfully submitted,

_____/s/_____
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Regulatory and Government
Relations Counsel

Attachment

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The Consumer Benefits of a Numbers-Based Collection Mechanism to Support the Federal Universal Service Fund

Issued by the USF by the Numbers Coalition

AT&T
CTIA - The Wireless Association ®
DSL.Net
GCI
IDT Corporation
National Cable & Telecommunications Association (NCTA)
USTelecom
Verizon
The VON Coalition

January 30, 2007

EXECUTIVE SUMMARY

The USF by the Numbers Coalition ("Numbers Coalition") is comprised of entities that support adoption of a mechanism that collects contributions to the $6.8 billion federal universal service fund (USF) in whole or in part based on consumers' working telephone numbers.[1] Fundamental changes in the communications marketplace make the current system – which collects USF funding based on telecommunications revenues – outdated. The Numbers Coalition presents this paper to explain the consumer benefits of transitioning from the current revenue-based contribution system to a numbers-based contribution system.

The current revenues-based system for funding the federal USF is economically irrational and confusing for consumers. Consumers today are benefiting from an explosion of innovative new technologies and services, and demand for triple-play offerings is rising dramatically. Each of these new service offerings, often provided for a fixed monthly rate that does not differentiate between local or long distance – although beneficial to consumers -- presents unique challenges for contributors not contemplated when the FCC adopted the current contribution methodology. The net result has been unnecessarily complex assessments of USF fees. Consumers are left unsure of the extent of the USF assessment for each service, leaving them unable to make informed purchasing decisions. Furthermore, because the current system assesses varying contributions depending on the technology used to deliver the service, the mechanism distorts the communications marketplace, creates unjustified discrimination, and causes some consumers to pay more than others using similar services.

A numbers-based collection mechanism can benefit consumers in many ways. A per-number fee would be simpler to administer and easier for consumers to understand. The Numbers Coalition estimates that the per-number fee would likely be no higher than $1.20 per month, which is about the same as the amount the average residential wireline consumer pays today. In addition, low-income Lifeline customers could be exempted from the fee, and other adjustments could be made if necessary, to ensure that low-volume and low-cost services are not unreasonably assessed. Adopting a numbers-based system would allow USF contributions to be shared more equitably among services and consumers.

The numbers-based system would be "revenue neutral" overall in that it would collect the same amount of fees as the current revenues-based system. In addition, because the base of working telephone numbers is increasing, a numbers-based contribution system would draw on an expanding base rather than the current revenue pool.

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[1] Individual members of the USF by the Numbers Coalition may support differing versions of specific reform plans.

The federal USF is intended to serve the important statutory goal of ensuring that telephone service is affordable for low-income and rural Americans. A numbers-based contribution mechanism is needed to achieve this goal in the 21st century and would deliver the following benefits for consumers:

- Make the USF fees more predictable and easier for consumers to understand;
- Provide for consistent or even reduced USF assessments for many residential (and especially rural) wireline consumers;
- Exempt Lifeline (low-income) consumers and allowing for other adjustments if necessary for low-volume and low-cost service;
- Make long distance calls more affordable for all consumers and especially rural consumers (who make more long distance calls than others); and
- Eliminate marketplace distortions caused by the current revenues-based system.

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The Consumer Benefits of a Numbers-Based Collection Mechanism to Support the Federal Universal Service Fund

Issued by the USF by the Numbers Coalition January 30, 2007

I. Introduction

The Federal Communications Commission (FCC) is considering revising the method of collecting assessments to support the federal Universal Service Fund (USF). Currently, the FCC requires each provider of telecommunications services to pay a percentage of its interstate and international end-user telecommunications revenues into the fund (the "revenues-based" system). Among the proposed alternatives is a system that assesses each company in whole or in part based on its working telephone numbers (the "numbers-based" system).

This paper examines the impact of both systems on consumers and concludes that a numbers-based system[2] has several important benefits for consumers, especially low-income and residential wireline consumers.[3] A numbers-based fee would be more equitable and predictable than the current system and would be easier for consumers to understand. As a whole, residential consumers of basic local wireline telephone service would pay about the same or slightly less under a numbers-based system than they pay today, and they would be able to make more long distance phone calls for less money.

Criticisms of a numbers-based system often reflect a misunderstanding of how the USF operates. For instance, some critics allege that a numbers-based system would penalize residential consumers because it would raise consumers' rates in 40 or perhaps all 50 states. In fact, the numbers-based system would be "revenue-neutral"; a numbers-based system would collect the same amount of funding as the revenues-based system does today (albeit in a different manner). Some observers also object to the flat-rate nature of a per-number fee, without realizing that consumers are already paying a flat monthly USF charge of about $.59 cents per line today even

[2] While the FCC has not endorsed any of the details concerning a numbers-based system, the major outlines of the plans submitted by a variety of parties are similar; carrier contributions would be based in whole or in part on working telephone numbers with an exemption for Lifeline/Link-Up customers as well as other low volume and low income consumers. For purposes of discussion, we use the term "numbers-based system" to refer to the commonalities of the various proposals.

[3] This paper does not examine the impact of migrating to a numbers-based contribution system on mobile wireless or interconnected Voice over IP consumers. Within the context of its numbers- and capacity-based contribution proposal, CTIA-The Wireless Association®, a member of this coalition, provided the FCC examples of the impact of numbers-based assessments on different types of wireless customers. *See* Letter from Paul Garnett, CTIA-The Wireless Association®, to Marlene Dortch, FCC, CC Docket No. 96-45, filed April 26, 2006.

if they make no long distance phone calls. Furthermore, the numbers-based system can be adjusted to accommodate certain user groups, by, for example, – exempting low-income consumers who receive "Lifeline" funding from any per-number fee (unlike today). Finally, because the base of telephone numbers is increasing, a per-number fee would more rationally link USF contributions to an expanding base rather than the current pool of interstate and international telecommunications revenues.

The following discussion explains these conclusions in more detail.

II. Background

The federal Universal Service Fund (USF or Fund) is intended to ensure that "consumers in all regions of the Nation, including low-income consumers and those in rural, insular and high cost areas" should have telephone service at reasonable rates.[4] The USF includes four different funding programs benefiting: 1) telecommunications companies serving high-cost areas of the country, 2) low-income consumers, 3) schools and libraries for telecommunications services and Internet access, and 4) rural health care providers for telecommunications and Internet access services. The Universal Service Administrative Company (USAC) administers the USF. USAC is responsible for identifying the funding needed for these four programs, collecting the funding from the communications industry, and distributing these funds under rules set forth by the FCC.[5]

Under the Telecommunications Act of 1996, "every telecommunications carrier that provides interstate telecommunications services" must contribute to the Fund. The FCC currently requires these providers to pay a percentage of their "end user, interstate and international telecommunications revenues" into the Fund. Most communications providers, however, offer a mix of interstate and intrastate services, telecommunications and information services, and wholesale and end-user services. Determining the portion of each provider's revenues that is subject to the USF assessment is extremely complex and inherently confusing, especially because retail consumers are ordering more and more "bundled" services.

After providers report their revenues into various categories, USAC determines the amount of the "contribution factor" by dividing the total USF needs by the total projected assessable revenues. USAC then calculates each provider's quarterly USF payments by multiplying its assessable revenues by the "contribution factor." The FCC adjusts this contribution factor every quarter depending on the revenue needs of the USF. On an annualized basis, the factor increased every year from 1999 through 2005 and was over 10% on an annualized basis for 2006.[6] Service

[4] See Section 254 of the Communications Act, as amended by the Telecommunications Act of 1996 (47 U.S.C. 254).

[5] This paper only addresses issues surrounding how funds are collected; issues related to the distribution of USF proceeds are outside the scope of this paper. The FCC has a number of active proceedings examining how funds are distributed.

[6] The contribution factor fluctuates from quarter-to-quarter due to a number of factors – including, for example, seasonal changes in demand and the revenue base and true-ups of prior-quarter projections. As explained below, the contribution factor is expected to continue to increase over time.

providers generally pass this cost onto their consumers, sometimes as a line item on their telephone bills (i.e., the "Federal Universal Service Charge").

Under a numbers-based system, each provider would pay into the Fund based on the number of working telephone numbers used by that provider, instead of paying a percentage of its revenues. While the exact amount of the per-number fee is still to be determined, the fee is expected to be in the range of $1.00 to about $1.20 per month per working telephone number.[7] As with the revenues-based system, providers would be permitted to collect this charge from their customers.

Shifting from a revenues-based collection method to a numbers-based collection method has absolutely no effect on the total amount of money collected (i.e., the numbers-based plan is "revenue neutral" overall). The USAC determines the amount of funding needed to meet the needs of the four programs for that quarter. Only after that figure is determined does the FCC determine the amount of the contribution factor (in the case of a revenues-based system) or the per-number fee (for the numbers-based system). Changing to a numbers-based system would not change the aggregate amount paid by consumers (business and residential) as a whole.[8]

The FCC and other regulators have experience with flat, per-line, cost recovery (e.g. the subscriber line charge (SLC), the local number portability (LNP) charge and the E-911 charge.)

III. American consumers, especially rural, residential wireline and low-income consumers, would benefit by shifting to a numbers-based collection system.

Fundamental changes in the communications marketplace have made the current revenues-based funding mechanism outdated. Consumers today are benefiting from an explosion of innovative new technologies and services, and demand for triple-play offerings is rising dramatically. Each of these new service offerings, often provided for a fixed monthly rate that does not differentiate between local or long distance – although beneficial to consumers -- presents unique challenges for contributors not contemplated when the FCC adopted the current contribution methodology. The net result has been unnecessarily complex assessments of USF fees. Consumers are left unsure of the extent of the USF assessment for each service, leaving them unable to make informed choices. Because the current system assesses varying contributions depending on the

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[7] While the per-number fee could vary depending upon a variety of factors, the per-number charge would not be as high as the $1.50 or $2 that is sometimes alleged by the Keep USF Fair Coalition. See, www.keepusffair.org.

[8] The Keep USF Fair Coalition contorts the issue by suggesting that the numbers-based system would raise more money than the current revenues-based system and would require consumers in every state to pay more than they receive. For instance, the Keep USF Fair Coalition recently made this illogical claim: "At the more likely $1.50 per-line charge level, all 50 states would end up paying in more than they are getting back." (see, http://keepusffair.org/KeepUSFFair/release_091306.html) Not only does this statement exaggerate the likely per-number fee, it also reflects a fundamental misunderstanding of how the USF operates. Except for the administrative expenses of running the program, *all* of the USF fees that are collected are re-distributed back to serve the purposes of the four programs. It is logically impossible for "all 50 states" to pay in more than they receive under either a revenues-based system or a numbers-based system.

technology used to deliver the service, the mechanism distorts the communications marketplace, creates unjustified discrimination, and causes some consumers to pay more than others using similar services.

In contrast, a numbers-based collection mechanism can benefit consumers in many ways. A per-number fee would be simpler to administer and easier for consumers to understand. The Numbers Coalition estimates that the per-number fee would likely be no higher than $1.20 per month, which is about the same as the amount the average residential wireline consumer pays today. In addition, low-income Lifeline customers could be exempted from the fee, and other adjustments could be made if necessary, to ensure that low-volume and low-cost services are not unreasonably assessed. USF contributions would be shared more equitably among services and consumers.

In addition, because the base of telephone numbers is increasing, an assessment based in whole or in part on working telephone numbers would more rationally link USF contributions to an expanding base rather than the current revenue pool. This would provide greater certainty to consumers and help to stabilize the funding for the USF for many years to come.

The federal USF is intended to serve the important statutory goal of ensuring that telephone service is affordable for low-income and rural Americans. A numbers-based contribution mechanism is needed to achieve this goal in the 21st century.

The following sections explain in greater detail why residential wireline consumers would benefit from replacing the current revenues-based system with a numbers-based system.

a. A numbers-based fee would be more predictable and easier for consumers to understand.

It is extremely difficult for consumers to understand how the current USF line item that appears on the phone bill is calculated. For instance, the current USF fee is NOT assessed on all long distance charges (because it does not apply to intrastate toll charges) and it is NOT assessed only on usage charges (because it is assessed on the SLC, which is a flat charge). The availability of flat monthly package plans adds to the confusion; consumers generally do not know what portion of their flat monthly payment is allocated to interstate use. Customer confusion concerning the fees on telephone bills is often a subject of concern to consumer advocates and policy-makers.[9] A flat, per-number fee would be much easier to identify, understand, and to calculate.

Unlike the current revenues-based system, a per-number fee would not vary with usage every month. This stability adds predictability to the cost of telephone service. Consumers can make their decisions about whether or not to sign up for telephone service knowing in advance how much the USF fee would be.

[9] See, National Association of State Utility Consumer Advocates' Petition for Declaratory Ruling, ("Truth in Billing Petition") filed March 30, 2004 in CC Docket 98-170.

The current USF fees on consumers' bills can be quite volatile. The current contribution factor twice jumped upward by 1.8% from one quarter to the next (from the 1st to the 2d quarter of 2003, and from the 4th quarter of 2004 to the 1st quarter of 2005), and the factor recently dropped by 1.4% (from the 3d quarter to the 4th quarter of 2006). Furthermore, the total USF fees can quickly rise to a high level during a month when a consumer who has a usage-based plan makes a lot of long distance phone calls (e.g., in family emergencies, or when children leave home). In contrast, the per-number fee would be more predictable from month to month because it would not vary based on usage.

b. Residential consumers of wireline local telephone service would, on the whole, pay about the same or slightly less under a numbers-based system.

Residential consumers of wireline local telephone service (i.e. basic local telephone service) would, on the whole, pay about the same or slightly less and receive more value under a numbers-based system than under the current revenues-based system.[10] The following discussion compares the effect of the two systems on residential wireline consumers.

Today, residential wireline telephone consumers pay a USF fee that is based on their total interstate and international telephone charges. There are at least two, and perhaps three, types of interstate and international charges that appear on each residential wireline consumer's telephone bill. The first two of these are fixed charges and the third is a usage-based charge:

- Subscriber Line Charge (SLC): The federal SLC is a fixed monthly charge that is assessed on almost all (non-Lifeline) local wireline telephone consumers, even if they make no long distance calls. The SLC is considered an interstate charge because it recovers local telephone companies' interstate costs of providing service. Service providers are allowed to charge up to $6.50 per month, but the charge varies slightly from provider to provider and state to state. The FCC has found that the average SLC for residential and single-line business customers is $5.92 (as of June 2006).[11]

- Monthly Packages: Many consumers today purchase a "basket" of local, long distance and other services under a pricing plan that charges the consumer a fixed monthly amount regardless of usage. For instance, several providers offer a package of unlimited local and domestic long distance calling for a flat rate of $39.99 per month (this pricing excludes the SLC and other taxes and regulatory fees). Providers must allocate a portion of their revenues from these monthly packages to the "interstate and international" category, and the consumer must

[10] The following analysis focuses only on residential consumers who purchase basic, wireline telephone service. It does not include an analysis of residential customers who purchase mobile wireless (cellular or PCS) or Voice over the Internet Protocol (VoIP) services, or business consumers.

[11] National Average Subscriber Line Charge based on latest FCC Monitoring Report Data for Primary-Line, Residential and Single-Line Business Customers, July 1, 2005 to June 30, 2006, Section 7, Table 7.11, available at http://www.fcc.gov/wcb/iatd/monitor.html.

pay a USF fee based on this portion whether or not he/she makes any long distance calls. In addition, some consumers subscribe to long distance plans that charge a minimum flat fee per month (e.g., $3.00 - $5.00) in order to receive a lower per minute rate. Thus, this monthly long distance minimum fee is also subject to USF charges.

- Long distance usage charges: Consumers also pay USF fees based on their usage-based interstate and international long distance phone call charges.

We can estimate the average wireline consumer's interstate and international charges by adding the amounts that consumers pay in SLC and usage charges (estimates of the average monthly package rates are unavailable). As mentioned above, the average SLC is $5.92. While the average consumer pays about $10 per month in long distance charges,[12] some of these charges are for intrastate calls, while others are for interstate and international calls. In a separate proceeding, the FCC reported that 65% of all wireline toll providers' revenues are interstate.[13] We can estimate the amount that the average residential wireline consumer pays in interstate and international long distance charges by multiplying $10 by 65%, which comes to $6.50. Thus, the average residential wireline consumer pays $12.42 in interstate and international charges per month ($5.92 in SLC and $6.50 in interstate and international long distance charges).

We can then estimate the amount that the average consumer pays in USF charges by multiplying this amount ($12.42) by the annualized 2006 contribution factor of 10%, which comes to $1.24. Since this number falls slightly above the range of the expected per-number fee of $1.00 to $1.20, the average wireline customer would likely see a slight reduction in his/her telephone bill as a result of moving to a numbers-based system.

This is not to say that all residential, wireline consumers would see a smaller phone bill. The effect on each consumer would vary depending on the amount of the SLC in that state and how much he or she pays in interstate and international charges today. Nevertheless, the above calculations show that the numbers-based system would certainly not have the catastrophic effect on consumers that opponents of the numbers-based plan sometimes allege.

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[12] Trends in Telephone Service, issued, June 21, 2005, Table 3.2, Average Monthly Household Telecommunications Expenditures By Type of Provider (available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend605.pdf.) This amount probably understates the consumer's actual monthly spending on interstate and international long distance calls because it only includes charges paid to long distance companies and thus excludes long distance charges paid to local exchange carriers and to wireless carriers, and it excludes data from Alaska and Hawaii.

[13] "The percentage of interstate revenues reported to the Commission by wireline toll providers is 64.9 percent." *Report and Order and Notice of Proposed Rulemaking*, in the Matter of the Universal Service Contribution Methodology, the Federal-State Joint Board on Universal Service, Released June 27, 2006, WC Docket No. 06-122, CC Docket No. 96-45, ("*VoIP USF Order*"), para. 53.

c. Unlike under the current system, a contribution methodology based on a per-number assessment would permit exemptions for Lifeline and other low income consumers.

Low-income consumers that receive assistance under the FCC's "Lifeline" program would fare better under a numbers-based system that is crafted to exclude Lifeline and other low income or low volume customers than under the current revenues-based system. The FCC's "Lifeline" program is designed to reduce the monthly telephone charges for low-income telephone consumers. Low-income consumers that sign up as a "Lifeline" customer receive a discount of up to $10 off their local telephone bill.[14] The discount is applied so that these consumers are not required to pay the federal subscriber line charge (SLC). Because Lifeline customers do not pay the SLC, they do not pay a USF charge on the SLC.

Nevertheless, Lifeline customers are not completely exempt from paying any USF charge today. Lifeline customers continue to pay a USF charge on their interstate and international long distance calls, just like any other consumer.

In contrast, under the numbers-based proposals submitted by many commenters, Lifeline consumers could be completely exempt from any USF contributions.[15] The numbers-based plans submitted by these parties would ensure that Lifeline customers do not pay any USF charge on either the SLC (which they are already exempt from paying) or on their long distance calls (as the numbers-based system would replace the current revenues-based assessment for this long distance service). As a result, Lifeline consumers who make long distance calls would pay less under the numbers-based system than they pay under the current revenues-based system.

[14] To qualify as a Lifeline customer, a customer must have an income no greater than 135 percent of the poverty level or participate in public assistance programs, including Medicaid, food stamps, supplemental security income, federal public housing assistance, low-income home energy assistance, temporary assistance to needy families and the national school lunch program.

[15] See, for example, the separate comments of AT&T, CTIA-The Wireless Association, the VON Coalition, and Verizon in WC Docket 06-122, August 9, 2006.

d. A numbers-based system is likely to be less volatile than the current revenues-based system.

The contribution factor under the current revenues-based approach has increased significantly over the past few years and is likely to continue to increase in the future. As shown by the chart below, the fee has increased from an annual average of 5.7% in 2000 to an annual average of 10.2% in 2006:

Quarterly Contribution Factors:

	1st Q	2d Q	3d Q	4th Q	Average
2000	5.9	5.7	5.5	5.7	**5.7**
2001	6.7	6.9	6.9	6.9	**6.8**
2002	6.8	7.3	7.3	7.3	**7.3**
2003	7.3	9.1	9.5	9.2	**8.8**
2004	8.7	8.7	8.9	8.9	**8.8**
2005	10.7	11.1	10.2	10.2	**10.55**
2006	10.2	10.9	10.5	9.1	**10.2**
2007	9.7				

The column on the right demonstrates that the annualized contribution factor has increased or remained stable every year from 2000 through 2005. The contribution factor remained stable for the first three quarters of 2006 (averaging 10.53% compared to 10.55% in 2005). While the contribution factor dropped in the 4th quarter of 2006, this change largely reflected true-ups of prior estimated amounts and, to a lesser extent, the FCC decision in the summer of 2006 to increase the USF contributions from VoIP and wireless services.[16] This fourth-quarter decrease does not change the long-term growth trend in the contribution factor, as evidenced by the increase in the 1st quarter of 2007 to 9.7%.

The contribution factor is likely to climb still higher because of changes in the numbers involved in its calculation. The contribution factor is derived from the following formula:[17]

$$\frac{\text{Total Size of the USF}}{\text{Total End User Interstate and International Revenues.}} = \text{Contribution Factor}$$

In this equation, the contribution factor would increase if: 1) the numerator increases, and/or 2) the denominator decreases. In fact, both are occurring: the total size of the USF is increasing, and the total base of revenues is stagnant or decreasing.

[16] See, *VOIP USF Order*, *supra*, note 8.

[17] This equation approximates but does not replicate the exact mathematical formula used by the USAC to determine the contribution factor. For instance, the actual formula contains adjustments to account for uncollectible revenues and to prevent double-counting.

The following chart shows the growth in the needs of the USF over the past 7 years:

The Size of the Universal Service Fund (Billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006
High Cost	1.7	1.9	2.6	2.8	3.3	3.4	3.8	3.9
Low Income	0.5	0.5	0.6	0.7	0.7	0.8	0.8	0.8
Sch & Lib	1.0	1.6	1.7	1.6	1.6	1.5	1.9	2.0
Rural Health	0.1	*	*	*	*	*	*	*
Total	**3.3**	**4.0**	**4.9**	**5.1**	**5.6**	**5.7**	**6.5**	**6.8**

* Less than $100 Million. (Totals may not add precisely due to rounding)
Source: USAC Filings to the FCC, and M02 appendices, available at http://www.usac.org/about/governance/fcc-filings/2006.

There are many reasons why the needs of the USF have risen, too many to review in this paper. The important point is that the USF has increased every year since 1999 and has more than doubled since then.

At the same time, the base of interstate and international revenues (the denominator), which was growing until the year 2000, has been stagnant or declining since then:

The Contribution Base for the Universal Service Fund in Relation to Telecommunications Revenues, 1997 to 2006

(Billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
End User Telecommun's Services	188.4	200.4	215.8	229.1	235.5	232.4	230.7	233.3	234.2	N/A
Contrib'n Base for USF	69.3	74.9	79.9	80.6	79.2	77.0	76.6	76.3	72.9*	74.9*+
% of Total Revenues	36.8	37.4	37.0	35.2	33.6	33.1	33.2	32.7	31.1	

Source: Congressional Budget Office based on Federal Communications Commission, Trends in Telephone Service (May 2004), Table 15.1, Telecommunications Industry Revenues (various years), Tables 1, 6, and 8 and Universal Service Monitoring Report, issued December, 2006, Table 1.1.
Notes: To avoid double taxation, the contribution base includes only revenues from services to end users.
To be consistent with previous years, 2003 through 2006 data include uncollectible revenues.
* Data for 2005 and 2006 compiled from FCC Public Notices announcing the quarterly USF Contribution Factors, CC Docket No. 96-45.
+ Almost all of this increase in the base of revenues in the 4th quarter of 2006 resulted from the FCC's decision to increase the USF payment obligations on wireless carriers and, for the first time, imposed USF contributions directly on interconnected Voice over IP (VoIP) providers. See, *VoIP USF Order*.

The graph attached as Appendix A (at the end of this paper) provides visual demonstration of these trends. The graph shows how the growth in the size of the USF has diverged from the relatively stable trend line tracking the base of interstate and international revenues. The base of revenues is simply not keeping up with the overall growth in the fund. This disparity is causing the contribution factor to increase to unacceptably high levels. Together, the charts above and

the graph in Appendix A demonstrate that the revenues-based system does not provide a viable long-term option for funding the universal service program for the future.

These trend lines are also bad news for consumers. Based on historical trends, the current 9.7% contribution factor is likely to continue on an upward track in the future, meaning that the amount of the USF contribution that consumers are going to pay under the current revenues-based system is likely to increase in the future as well.

Shifting to a numbers-based approach, however, produces a different result, i.e., a new system promoting USF stability. Using a numbers-based system does not affect the numerator (the size of the USF) in the equation identified above, but it would change the denominator. While the base of interstate and international revenues is stagnant or in decline, the number of working telephone numbers is increasing. According to the Ad Hoc Telecommunications Users Committee, the number of "assigned" numbers grew at an annualized rate of 5% per year from December 2000 until December 2004.[18] The graph in Appendix A shows that the growth in the number of telephone numbers (the denominator) has increased at about the same rate as the growth in the USF (the numerator).

As a result, the numbers-based system may provide even greater benefits to residential wireline consumers in the future than it would today. If the contribution factor continues to rise, as it has for almost its entire history, the average residential wireline consumer will soon be paying much more than $1.24 in USF fees. Thus, a per-number fee in the range of $1.00 to $1.20 is likely to be more stable and less volatile over time than the current revenues-based fee.

e. A numbers-based system would eliminate the anachronistic penalty on long-distance callers.

The Universal Service program is not directly related to recovering costs associated with long-distance or international telephone calls. Instead, its funding mechanism was simply adopted at a time when long-distance calling was generally believed to be used mostly by wealthier Americans who could afford to underwrite the USF program. Today, however, fiber-optic technologies and competitive flat rated calling plans, along with the nationalization and globalization of today's market, have made long-distance and even international calling both an affordable and essential part of the lives of most Americans, especially immigrants. This is especially true of rural families, who have fewer residents in their local calling areas and thus make more long distance calls than their urban counterparts. The USF fee on interstate and international calls discourages consumers from making long distance calls and impacts consumers at all income levels.

[18] See, *ex parte* filing by James Blaszak on behalf of the Ad Hoc Telecommunications Users Committee (Ad Hoc) in *Federal-State Joint Board on Universal Service 1998 Biennial Regulatory Review*; WC Docket No. 06-122, August 11, 2006. While the Ad Hoc filing uses "assigned" numbers rather than "working" numbers, there is no reason to believe that the growth rates should differ. Ad Hoc states, "[t]he quantity of numbers "assigned" appears to be growing steadily with no signs of growth abating (see Table 2) – meaning that a numbers-based system should also be able to sustain additional growth in the fund itself . . ."

Updating the USF program to reflect this 21st century reality is long overdue. By disproportionately assessing long-distance and international calling, the current revenues-based fee causes a welfare loss for society as a whole. Professor Jerry Hausman of MIT and others have found that the current USF revenues-based fee is one of the most inefficient among all federal assessments. Professor Hausman calculates that American consumers lose more than $2 in consumer welfare for every dollar collected for universal service.[19] Furthermore, Dr. Jerry Ellig of George Mason University estimated that, when the contribution factor was about 8% in 2002, the national economy suffered a total reduction in economic welfare of $1.16 billion.[20]

In contrast, the great benefit of a flat, per-number fee is that it does not discourage consumers from making each additional long-distance call. By simply restructuring the collection mechanism, American consumers would be able to make more long distance calls for their dollar. This system would give consumers greater control over their usage of long distance telephone service, unimpeded by extra government usage fees.

f. The effect of a numbers-based plan on low-volume wireline consumers would be minimal.

The discussion above demonstrates that residential consumers of wireline telephone service will pay about the same, or slightly less, under a numbers-based plan, that Lifeline consumers would be better off under a numbers-based system because they would be exempt from paying any USF fee, that residential wireline consumers may realize even more cost savings in the future, and that wireline consumers will be able to make more long distance calls for their dollar. Some observers, nonetheless, object to a numbers-based system because of its potential effect on "low-volume" consumers. The following analysis shows that the effect of a numbers-based system on low-volume wireline consumers would be minimal.

As explained above, wireline consumers who make no long distance telephone calls pay into the USF today based on the SLC. Because the average SLC is $5.92[21] and the contribution factor is about 10%, consumers who make no long distance calls are today paying an average of $.59 per month in flat USF fees. While this amount is less than the estimated per-number fee of between $1.00 and $1.20, the total increase that would be paid by consumers who make no long distance telephone calls would amount to only 41 cents to 61 cents per month. On a basic local phone bill of $20, this would amount to an increase of about 2% to 3%, which is no greater than the rate of inflation over the past few years.

Furthermore, it would not take many long distance phone calls for even low-volume wireline consumers to begin to realize some cost savings. As the chart below shows, if the per-number fee is set at $1.20, then the "average SLC" customer saves money:

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[19] J. Hausman, *Taxation by Telecommunications Regulation: The Economics of the E-Rate*, AEI Press, 1998.

[20] J. Ellig, *Costs and Consequences of Federal Telecommunications Regulations*, Federal Communications Law Journal, Vol. 58, (2006), p. 59.

[21] Under the current system, if the SLC ever increases, the flat USF fee associated with the SLC would increase as well. In contrast, SLC increases would have no impact on numbers-based assessments.

		Current Revenues-Based System	Proposed Numbers-Based System	Which is Better for the Consumer?
Lifeline	No long distance calls	$0	$0	**Equal**
	Some long distance calls	10% x cost of the long distance calls	$0	**Numbers**
Non-Lifeline	No long distance calls	10% x Nat'l Ave. Subscriber Line Charge ($5.92)* = $.59	$1.20	**Revenues**
	More than $6.10 in long distance calls	10% x SLC ($5.92) = $.59 10% x $6.10 = $.61 $.59 + $.61 = $1.20.	$1.20	**Numbers**

* National Average Subscriber Line Charge based on latest FCC Monitoring Report Data for Residential and Single-Line Business Customers, July, 1, 2004 to June 30, 2005, Section 7, Table 7.11, available at http://www.fcc.gov/wcb/iatd/monitor.html.

As the chart shows, Lifeline customers would either be unaffected by or would benefit from a numbers-based system. Non-Lifeline wireline customers who make more than $6.10 per month in interstate and international long distance calls (if the per number fee is $1.20) would pay less under a numbers-based system than they pay today. The only group of wireline consumers that may be somewhat worse off under a numbers-based system are those who make less than $6.10 in interstate and international long distance phone calls per month (if the per number fee is $1.20).

How many customers fall into this category? Unfortunately, there is little data available to determine how many residential wireline telephone consumers make fewer than $6.10 in long distance phone calls per month.[22] What we do know is that consumers that do not subscribe to a monthly plan, who could often be low-volume consumers, pay a higher per-minute usage charge for each long distance phone call than those who do not, which will cause them to pay a higher USF surcharge for each long distance phone call they make.

Even though low-volume wireline consumers may pay slightly more in USF fees under a numbers-based system today, that price differential may disappear in a few years. As explained above, the contribution factor under the revenues-based approach is expected to continue to rise, while the per-number fee may remain relatively stable. It is not inconceivable that, in the future, wireline consumers who make absolutely no long distance phone calls would pay *less* in USF

[22] One estimate that there are 43 million American households that can be classified as low-volume consumers appears to rely upon data that is almost a decade old and is thus inapplicable today. See, http://keepusffair.org/img/gv2/nonstandard_files/keepusffair/Losing-numbers-report.pdf (citing to a 1999 filing by the Consumer Federation of America/Consumer's Union that quotes an FCC Report, Trends in Telephone Service, issued in 1998, which reports data from 1997.)

contributions under a per-number system than they would pay under the current revenues-based system.

g. A numbers-based system is necessary to eliminate artificial distortions in the marketplace.

The current revenues-based system also harms consumers by unreasonably distorting the marketplace. Because the USF assessment is only imposed on a subset of all revenues, the system gives providers incentives to alter their service offerings or shift their revenues in order to avoid paying the fee. The marketplace thus becomes skewed for regulatory reasons, not because of the natural efficiencies of the services being offered. The current revenues-based system may arbitrarily encourage inefficient business practices and penalize efficient ones. Thus, consumers may not receive the full benefit of the technological changes, and other advantages of a fully competitive marketplace.

The complexity of applying the usage-based fee itself creates significant disparities among competing technologies. Wireless services, VoIP services, traditional long distance services, special access services, prepaid services, and bundled packages are each assessed USF fees in a different manner. Determining how to apply a usage-based fee to each of these services creates enormous challenges. The application of USF assessments to each of these services has significant effects on the marketplace.

For example, since some services today are assessed a USF contribution while other comparable services are not, the disparity in regulatory treatment skews the marketplace and frustrates the ability of providers to offer their services in the manner most advantageous to consumers.

CTIA-The Wireless Association® recently brought to light a specific example of the difficulty of carrying out the revenues-based system. On August 1, 2006, CTIA submitted a Petition for Declaratory Ruling concerning wireless carriers' universal service contributions.[23] The Petition notes that the universal service forms' instructions currently refer to "local exchange calling areas," a term typically used for wireline service that does not apply to wireless services. The Petition also notes that the FCC has never adopted a definition of "toll" services. The definitions of both these terms are critical for carriers to determine how much of their revenues should be allocated to "interstate and international service" to calculate their USF assessment. This petition is just one example of the uncertainty that results from trying to shoehorn a changing telecommunications marketplace into old, and often ambiguous, regulatory categories.

In contrast, moving to a numbers-based system would eliminate many if not all of the discrepancies associated with the current system. Such reforms therefore would reduce market distortions and enable consumers to make purchasing decisions based on more accurate pricing signals.

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[23] See, Petition for Declaratory Ruling of CTIA-The Wireless Association® on Universal Service Contributions, August 1, 2006.

h. A numbers-based system would be simpler to administer.

The current revenues-based system is increasingly difficult to administer. The current rules only permit the FCC to collect fees based on "end user, interstate and international, telecommunications" revenues. Many providers, however, offer "baskets" of services that do not distinguish between local and long distance services, or between telecommunications and information services. Identifying the revenues that are assessable under the FCC's current USF rules is becoming increasingly difficult. As a result, the current system distorts the communications marketplace, creates unjustified discrimination, and causes some consumers to pay more than others using similar services.

Changing the system from a revenues-based fee to a numbers-based fee would greatly simplify the collection process in a way that would benefit consumers and the marketplace. Although a numbers-based system would take some time to implement, once established, it would be relatively straightforward to determine how many working telephone numbers are used by each provider and how much each provider must pay. A numbers-based system would thus reduce administrative costs to the providers, to the USAC and to the FCC. Furthermore, under a numbers-based system, it would be easier to ensure compliance with the FCC's rules. As a result, the USF fees passed through to consumers are more likely to be clear and understandable.

V. Conclusion

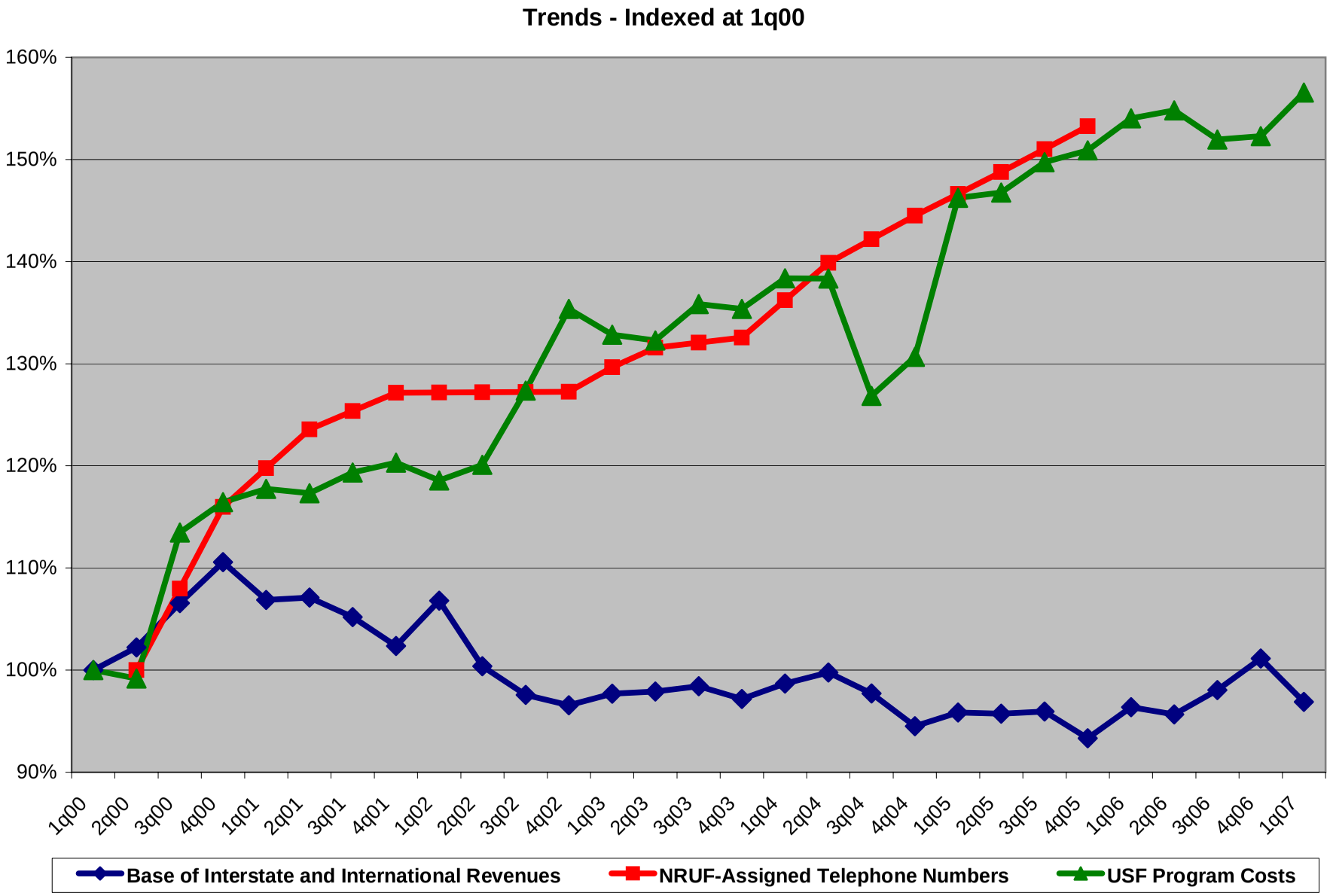
The numbers-based system for collecting federal USF contributions has many important benefits for consumers. A per-number fee would be simpler to administer and easier for consumers to understand. The Numbers Coalition estimates that the per-number fee would likely be no higher than $1.20 per month, which is about the same as the amount the average residential wireline consumer pays today. In addition, low-income Lifeline customers could be exempted from the fee, and other adjustments could be made if necessary, to ensure that low-volume and low-cost services are not unreasonably assessed. USF contributions would be shared more equitably among services and consumers. The numbers-based USF fee does not discourage telephone usage and thus increases consumer welfare as a whole. Consumers would be able to make more long distance calls for their dollar than they do today.

The impact on low-volume wireline residential consumers is likely to be minimal. Today, the average wireline consumer pays a monthly USF fee of approximately $.59, *even if he/she makes absolutely no long distance phone calls*. As a result, any increase to the bills paid by low-volume wireline consumers is likely to be minor ($.41 to $.61 per month) and is likely to be temporary.

Finally, a numbers-based fee does not skew the marketplace and is much easier to administer once it is put in place. Consumers would benefit from a more predictable funding source for the USF and from a more efficient marketplace.

The USF program provides important benefits to rural Americans, to schools and libraries, to rural health care providers and to low-income Americans. These important programs are in jeopardy, however, because the current revenues-based system is simply out of step with today's market. The changes in the marketplace make it extremely difficult to collect the revenues-based fee in a fair and economical manner. Unless the FCC makes a responsible change to the method of collecting revenues, the entire USF program may be at risk. A numbers-based system would eliminate or reduce many of these inefficiencies and broaden the base of funding, thereby putting the USF on more solid footing for many years to come.

Attachment A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Base of Interstate and International Revenues
NRUF-Assigned Telephone Numbers
USF Program Costs